Supreme Court, U.S.
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No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

WILLIAM T. WARTHEN AND HARRY J. WARTHEN, III
Petitioners,

v.

LARRY DANE SMITH, II
Respondent.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Fourth Circuit

PETITION FOR WRIT OF CERTIORARI

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I. QUESTION PRESENTED

Whether 11 U.S.C. § 506(d), as interpreted by the Court in Dewsnup v. Timm, 502 U.S. 410 (1992), precludes a debtor in a chapter 7 bankruptcy case from "stripping off" non-consensual judgment liens that currently have no value?

II. PARTIES

All the parties to the proceedings below are identified in the caption of this case except W. Stephen Scott, the chapter 7 bankruptcy trustee of Respondent, Larry Dane Smith, II. Although Mr. Scott was served with the pleadings filed in connection with the proceedings before the bankruptcy court in this case, he did not participate in those proceedings and ceased to be a party in interest when he abandoned the bankruptcy estate's interest in the real property to which the judgment liens at issue in this case attached.

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V. LOWER COURT CASE CITATIONS

The opinion of the United States Court of Appeals for the Fourth Circuit appears at Appendix 1 and is unpublished, but reported electronically at 2001 WL 22918 (4th Cir. Jan. 10, 2001).

The order and memorandum opinion of the United States District Court for the Western District of Virginia appears at Appendix 8, and is reported at 247 B.R. 191 (W.D. Va. 2000).

The order and memorandum opinion of the United States Bankruptcy Court for the Western District of Virginia appears at Appendix 23 and is unpublished.

VI. STATEMENT OF JURISDICTION

Petitioners, William T. Warthen and Harry J. Warthen, III, seek review of an opinion issued by the United States Court of Appeals for the Fourth Circuit on January 10, 2001. This Court has jurisdiction to issue a writ of certiorari pursuant to 28 U.S.C. § 1254(1).

VII. STATUTORY PROVISIONS

A. 11 U.S.C. § 506(a).

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of

such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

B. 11 U.S.C. § 506(d).

To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless –

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

C. 11 U.S.C. § 502, reprinted at App. 38.

VIII. STATEMENT OF THE CASE

The Warthens' Judgments

On June 30, 1998, a jury in the Circuit Court for the City of Richmond, Virginia awarded judgments against the Respondent, Larry Dane Smith, II (the "Debtor"), to Petitioners, William T. Warthen and Harry J. Warthen, III (together, the "Warthens"), in the amounts of $280,000.00 and $56,722.41, respectively. App. 2. The lawsuit was triggered by an auto accident in which the Debtor was at fault. App. 2. The jury awarded damages for permanent

physical injury suffered by William T. Warthen, a minor at the time of the accident, as well as incidental medical costs expended by William's father, Harry J. Warthen, III. App.2-3.

The Real Property and its Encumbrances

The Debtor owns an undivided one-half interest as a tenant in common in certain real property and improvements located near Palmyra in Fluvanna County, Virginia (the "Real Property") App. 3. The Real Property's assessed value is $64,600, but the Real Property is encumbered by a first mortgage lien in the amount of $70,768.38. App. 3. Accordingly, the Debtor has no equity in the Real Property. App. 3. Nevertheless, the Warthens proceeded to docket their judgments in the land records of Fluvanna County, Virginia on July 8, 1998, and thus, under Virginia law, obtained judicial liens against the Debtor's interest in Real Property. App. 3.

The Debtor's Chapter 7 Bankruptcy Case

On September 30, 1998, the Debtor filed a voluntary petition for relief under chapter 7 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"), in the United States Bankruptcy Court for the Western District of Virginia. App. 3. The Warthens did not file proofs of claim for their judgments in the Debtor's bankruptcy case, relying instead on the principal that their judicial liens on the Real Property would "pass through" bankruptcy unaffected. App. 6 n.2. The Debtor, however, filed pleadings with the bankruptcy court seeking various remedies against the Warthens' judicial liens on the Real Property, including a request that such liens be "voided" under § 506(d) of the Bankruptcy Code. App. 3-4. Because the facts of the case were undisputed, each side moved for summary judgment

pursuant to Fed. R. Civ. P. 56(b), as incorporated by Fed. R. Bankr. P. 7056(b). App. 4. In their motion for summary judgment, the Warthens argued that the Court's interpretation of § 506(d) enunciated in Dewsnup v. Timm, 502 U.S. 410 (1992), precluded the Debtor from using that statute to void the Warthens' judicial liens as a matter of law. App. 32.

The Bankruptcy Court's Ruling

On May 21, 1999, the bankruptcy court entered an order and corresponding memorandum opinion denying the Warthens' motions for summary judgment with respect to § 506(d) and granting the Debtor's motion to void the Warthens' judicial liens under § 506(d). App. 23-37. The bankruptcy court distinguished Dewsnup as a case involving the "stripping down" of an "undersecured" lien—a lien that has some value, albeit not enough to secure the attendant claim in full—rather than the "stripping off" of a "wholly unsecured" lien—a lien that currently has no value at all. App. 31-34. The bankruptcy court reasoned that wholly unsecured liens, such as the Warthens' judicial liens, do not secure "allowed secured claims" within the meaning of § 506(d) and, therefore, can be "stripped off" under § 506(d). App. 33-34.

The District Court's Ruling

The Warthens appealed the bankruptcy court's ruling to the United States District Court for the Western District of Virginia. App. 7; see 28 U.S.C. § 158(a). In an order and memorandum opinion issued on March 14, 2000, the district court affirmed the bankruptcy court's ruling. App. 8-22. Like the bankruptcy court, the district court distinguished Dewsnup on the ground that it involved the stripping down of an undersecured lien, rather than the stripping off of a wholly unsecured lien. App. 18-

19. However, the district court also distinguished Dewsnup as a case involving a consensual mortgage lien, rather than a non-consensual judgment lien, such as those held by the Warthens. App. 17-18.

The Fourth Circuit's Ruling

The Warthens appealed the district court's affirmance of the bankruptcy court's ruling to the United States Court of Appeals for the Fourth Circuit. App. 7; see 28 U.S.C. § 1291. Following the majority of lower federal courts, the Warthens argued that the Court's interpretation of § 506(d) in Dewsnup precludes the "stripping off" of "wholly unsecured" non-consensual judgment liens like the Warthens' judicial liens every bit as much as that interpretation precludes the "stripping down" of "undersecured" consensual mortgage liens. Finding itself in "substantial agreement" with the "analysis and conclusions" of the bankruptcy court and the district court, the Fourth Circuit issued a *per curiam* unpublished opinion affirming the voiding of the Warthens' judicial liens on the reasoning of the lower courts in their respective memorandum opinions. App. 7. The Fourth Circuit observed that the bankruptcy court had discerned nothing in the Court's decision in Dewsnup "that would preclude a worthless lien from being 'stripped off' to effectuate the broad policy goals of the bankruptcy laws." App. 6-7. The Fourth Circuit followed that observation with the following footnote:

> In Dewsnup, the Supreme Court implicitly endorsed the view of the respondents therein that "the 'fresh start' policy cannot justify an impairment of [the lienholders'] property rights." In this case, however, the Warthens' property rights are not significantly impaired; if the Real Property were sold at

> market value, all of the proceeds would be used to satisfy the mortgage debt. Nothing would be distributed to the Warthens.

App. 7 n.3 (citation omitted).

IX. ARGUMENT

This case presents the Court with a rare opportunity to resolve an important, widespread and recurring issue in consumer bankruptcy law—the ability of a chapter 7 debtor to void or "strip off" non-consensual judgment liens that happen to lack value upon the commencement of bankruptcy. Although this issue appeared to have been resolved by the interpretation of § 506(d) of the Bankruptcy Code enunciated by the Court in Dewsnup v. Timm, 502 U.S. 410 (1992), lower federal courts have persisted in developing result-oriented bases for distinguishing Dewsnup and remain evenly divided on the issue. The Fourth Circuit's decision in this case demands review because the interpretation of § 506(d) it relied upon to strip off the Warthens' judicial liens is squarely inconsistent with the interpretation given that statute by the Court in Dewsnup and because it directly conflicts with the holding of the United States Bankruptcy Appellate Panel of the Ninth Circuit in Laskin v. First Nat'l Bank of Keystone (In re Laskin), 222 B.R. 872 (B.A.P. 9th Cir. 1998). Additionally, the ever-growing division among district courts and bankruptcy courts on this issue and the resulting lack of uniformity of treatment from jurisdiction to jurisdiction call out for definitive guidance from the Court.

A. The Court Must Resolve the Conflict Between the Interpretation of § 506(d) Articulated by the Court in Dewsnup v. Timm and the Interpretation of That Statute Adopted by the Fourth Circuit.

In Dewsnup v. Timm, 502 U.S. 410 (1992), the Court held that § 506(d) of the Bankruptcy Code does not permit a debtor in a Chapter 7 bankruptcy case to "strip down" a lien, i.e., to void a lien to the extent its judicially determined value is less than the amount of the claim it secures. In so holding, the Court interpreted § 506(d) as serving the "simple and sensible function" of voiding a lien when the claim the lien secures has not been allowed under § 502 of the Bankruptcy Code. Id. at 415-16. Under the Court's interpretation of § 506(d) in Dewsnup, if the lien secures a claim that is allowable under § 502, that ends the inquiry: § 506(d) has no application, and the lien cannot be voided, even if the lien is worth significantly less than the amount of the claim. See id. The Court in Dewsnup expressly rejected the argument that a claim is "secured" under § 506(d), and the corresponding lien immunized from being voided under § 506(d), only to the extent of the judicially determined value of the lien under § 506(a) of the Bankruptcy Code. Id. at 416-17. Under Dewsnup, allowability of the claim secured by the lien is the touchstone; value of the lien is irrelevant. E.g., Lawrence P. King, Collier on Bankruptcy, ¶ 506.06[1][a] at 506-148 (15th ed. 2000) (stating that the Court in Dewsnup "determined that section 506(d) does not void liens on the basis of whether they are *secured* under section 506(a), but on the basis of whether the underlying claim is *allowed or disallowed* under section 502") (emphasis added).

In permitting the debtor in this case to "strip off" the Warthens' judicial liens, the Fourth Circuit adopted an interpretation of § 506(d) that is flatly inconsistent with the Court's interpretation of that statute in Dewsnup. By relying on the current lack of value in the Warthens' judicial liens as a basis for voiding those liens in their entirety under § 506(d), the Fourth Circuit effectively resurrected the value-driven interpretation of what it means to be "secured" under § 506(d) that the Court in Dewsnup expressly laid to rest. The rulings of the bankruptcy court and the district court below are predicated on the flawed legal premise that the Warthens' judgments do not qualify as "secured" claims under § 506(d) because the corresponding judicial liens currently are worthless. The notion that a lien's value determines its voidability under § 506(d) is precisely the proposition of law that was rejected by the Court in Dewsnup. The Fourth Circuit's affirmance of the lower courts' rulings in this case, therefore, directly conflicts with Dewsnup.[1]

The analysis and holding in Dewsnup teaches that the sole relevant criterion for determining the voidability of a lien under § 506(d) is whether the claim the lien secures is allowable under § 502 of the Bankruptcy Code. If that is so—if allowability of the claim, rather than value of the lien, is the critical inquiry—then not only is the current value of the Warthens' judicial liens irrelevant to their voidability, so, too, is the fact that the Warthens'

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[1] As Professor David Gray Carlson has pointed out, such an analysis also is inconsistent with United States v. Whiting Pools, Inc., 462 U.S. 198 (1983), in which the Court ruled, *inter alia*, that a property interest does not lose its character as such simply because it currently has no value in the marketplace. David Gray Carlson, Bifurcation of Undersecured Claims in Bankruptcy, 70 Am. Bankr. L.J. 1, 25 (1996).

liens are non-consensual judicial liens rather than consensual mortgage liens. Accordingly, the lower courts' attempts in this case to distinguish Dewsnup on the ground that it involved consensual liens with some market value (albeit not enough to secure the related claim in its entirety), rather than non-consensual judicial liens that currently lack any value, are misguided. The Court in Dewsnup pronounced allowability of the claim as the dispositive criterion in determining the voidability of the lien under § 506(d),[2] and there is simply no principled basis on which to stray from the Court's interpretation merely because the liens at issue are non-consensual judicial liens that happen to lack value upon the commencement of bankruptcy.

The Fourth Circuit's decision in this case provides the Court with an appropriate vehicle for clarifying these important outstanding issues regarding the scope of the Court's holding in Dewsnup.

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[2] Although Dewsnup describes the sole criterion as whether a claim is "allowed" rather than "allowable," § 506(d)(2) makes it clear that the lien-voiding mechanism of § 506(d) does not apply to liens securing claims that have not been "allowed" solely because of the claimant's failure to file a proof of claim. E.g., Schroeder v. First Union National Bank of Virgnia, 182 B.R. 723, 724 n.2 (D. Md. 1995); see also App. 6 n.2.

B. The Court Must Resolve the Split Between the Fourth Circuit and the Ninth Circuit Bankruptcy Appellate Panel as to Whether 11 U.S.C. § 506(d) Precludes Debtors in Chapter 7 Bankruptcy Cases From "Stripping Off" Non-Consensual Judgment Liens That Lack Value.

The Fourth Circuit's decision also conflicts with the holding and rationale of the United States Bankruptcy Appellate Panel of the Ninth Circuit in Laskin v. First Nat'l Bank of Keystone (In re Laskin), 222 B.R. 872 (B.A.P. 9th Cir. 1998). In Laskin, the court held that debtors in "no asset" chapter 7 bankruptcy cases lack standing to use the lien-voiding mechanism of § 506(d). Id. at 874-75. The court reasoned that in "no asset" chapter 7 bankruptcies, no claims allowance proceedings take place; accordingly, such cases lack the essential predicate for voiding a lien under § 506(d)—disallowance of the related claim under § 502 of the Bankruptcy Code. Id.

In the alternative to that holding, which clearly comports with Dewsnup's emphasis on allowability of the claim instead of the value of the lien that secures the claim, the court in Laskin held that even if a debtor in a no-asset chapter 7 bankruptcy has standing to bring a lien voiding action under § 506(d), Dewsnup bars such a debtor from stripping off a wholly unsecured lien. Id. at 875-76. The Laskin court held that the underlying rationale of the Court's decision in Dewsnup, including the policies that liens should "pass through" bankruptcy unaffected and that any increase in the value of collateral should inure to the benefit of the creditor, are equally applicable when the lien sought to be voided is wholly unsecured. Id.

With the Fourth Circuit's decision in this case, there is now a mature split with the Ninth Circuit Bankruptcy Appellate Panel as to whether a lien's lack of value upon the commencement of bankruptcy permits the lien to be "stripped off" under § 506(d), as interpreted by the Court in Dewsnup.

C. The Court Must Provide Guidance to the Lower Federal Courts, Which are Evenly Divided on These Important Consumer Bankruptcy Issues.

Since Dewsnup, lower federal courts have generated nearly a decade's worth of inconsistent rulings on whether § 506(d) permits Chapter 7 debtors to strip off liens that happen to lack value upon the commencement of a bankruptcy case. Lower federal courts are equally divided on whether Dewsnup precludes the strip off (or strip down) of non-consensual liens, such as judgment liens, as opposed to consensual mortgage liens. Compare, e.g., Cater v. American Gen. Fin. (In re Cater), 240 B.R. 420 (M.D. Ala. 1999) (holding that Dewsnup precludes chapter 7 debtors from stripping off "wholly unsecured" mortgage liens under § 506(d); Schroeder v. First Union Nat'l Bank of Va., 182 B.R. 723, 724 (D. Md. 1995) (same as to judicial liens); In re Fitzmaurice, 248 B.R. 356 (Bankr. W.D. Mo. 2000) (same as to junior mortgage liens); Cunningham v. Homecomings Fin. Network (In re Cunningham), 246 B.R. 2 (Bankr. D. Md. 2000) (same; on appeal to the Fourth Circuit); Swiatek v. Pagliaro (In re Swiatek), 231 B.R. 26, 29 (Bankr. D. Del. 1999) (same as to judgment liens); In re Esler, 165 B.R. 583, 584 (Bankr. D. Md. 1994) (holding that Dewsnup applies equally to consensual and non-consensual liens and precludes the strip down of undersecured judgment liens in chapter 7 cases); In re Mershman, 158 B.R. 698, 703 (Bankr. N.D.

Ohio 1993) (citing cases and refusing to strip down valueless judicial lien in chapter 7 case under Dewsnup) with Yi v. Citibank (In re Yi), 219 B.R. 394 (E.D. Va. 1998) (distinguishing Dewsnup and permitting strip off of "wholly unsecured" junior mortgage in chapter 7 case); Farha v. First Am. Title Ins. (In re Farha), 246 B.R. 547 (Bankr. E.D. Mich. 2000) (denying motion to dismiss complaint to strip off "entirely unsecured" junior mortgage in chapter 7 case); Zempel v. Household Fin. Corp. (In re Zempel), 244 B.R. 625 (Bankr. W.D. Ky. 1999) (distinguishing Dewsnup and granting chapter 7 debtor's summary judgment motion seeking strip off of junior mortgage lien); Howard v. National Westminister Bank (In re Howard), 184 B.R. 644 (Bankr. E.D.N.Y. 1995) (distinguishing Dewsnup as a case involving a consensual mortgage lien and permitting strip off of wholly unsecured judicial lien in Chapter 7 case).

This case presents the Court with an important opportunity to resolve the widespread and growing disparity in treatment of these recurring consumer bankruptcy issues from jurisdiction to jurisdiction.

X. CONCLUSION

For the foregoing reasons, the Warthens respectfully request that the Court issue a writ of certiorari to the United States Court of Appeals for the Fourth Circuit in this case.

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